

The complaint

H, a limited company, complains Royal & Sun Alliance Insurance Limited turned down a claim it made on its business protection insurance policy.

What happened

H operates a hydro power plant. In January 2020 it took out insurance with RSA which included cover for business interruption and damage. The following November the hydro generator was reconnected to the grid after a ten-week outage and experienced a short circuit. H claimed on its policy for the repair costs and business interruption.

After reviewing evidence (and obtaining expert advice) RSA turned down the claim. It said the policy excluded claims where the damage was caused by wear and tear (as defined in the policy). And it thought that applied here because it said the generator failure was caused by gradual deterioration and corrosion in damp atmospheric conditions. It maintained that position in response to the complaint H subsequently made.

In her most recent view, our investigator noted that reports from a specialist (who inspected the generator after it failed) and the specialist maintenance operator didn't agree the failure was caused by corrosion. And while RSA's expert thought it was, he hadn't inspected the site and was solely reliant on the photographs supplied by the specialist who had. She didn't agree RSA had fairly turned down the claim and said it should reconsider this subject to the remaining terms and conditions of the policy.

She asked RSA to let her know whether it accepted her opinion by 31 May 2024 and sent a further chaser at the end of May. As no response was received from RSA, at the start of June she confirmed to both parties the complaint would be reviewed by an Ombudsman and asked for any further comments by 17 June. As no response has been received from RSA, I need to reach a final decision.

What I've decided – and why

I've considered all the available evidence and arguments to decide what's fair and reasonable in the circumstances of this complaint.

The relevant rules and industry guidelines say RSA has a responsibility to handle claims promptly and fairly. It shouldn't reject a claim unreasonably.

I've considered first the terms and conditions of H's policy. This provides cover for damage to property and resultant business interruption. The policy defines damage as "*physical loss or destruction of or damage to the Property howsoever caused (including Machinery Breakdown Pressure Explosion and Collapse) except as herein excluded*". And I don't think it's in dispute the generator would fall within the definition of "*property*" the policy contains.

So, in principle, it could cover the claim H made. But the policy contains a list of 'Excluded Causes' which it doesn't cover. One of those is listed as '*Wear and Tear*' which it defines as:

"Normal and natural

- A) wasting wearing away or wearing out gradual deterioration rust or oxidation*
- B) corrosion or*
- C) erosion"*

RSA has also referenced the following term which excludes:

"Damage or Consequential Loss caused by or consisting of

- A) gradual deterioration wear and tear inherent vice latent defect or frost"*

RSA said in its final response to the complaint its reasons for declining the claim were because "*reports suggest historic issues with overheating of the generator, and while heaters may have been present during the two month period of inactivity, a lack of humidity control and conductive heating has ultimately led to further corrosion and the unit's eventual failure when restarted. While there is no question that the failure itself was sudden, the evidence to hand shows that, on the balance of probability, the unit has failed due to gradually operating causes*".

In response to our inquiries RSA told us "*It was clear from the provided reports that the corrosion which led to the failure of the unit had been caused over a period of time, and as such the wear and tear policy exclusion applied*". So RSA seems to be relying on the policy exclusions as they relate to gradual deterioration and wear and tear. But it appears primarily to be arguing that the failure of the generator was because of corrosion (which had been exacerbated during the period the generator was offline).

I think it's accepted the actual failure of the generator resulted from a short circuit when it was re-energised following an outage. And I'm not persuaded the cause of the resultant damage could reasonably be said to be wear and tear. I think for that to be the case RSA would need to show the damage was the result of the normal everyday use of the generator and the inevitable aging of relevant parts associated with that. But in this case I understand the generator was installed in 2002 and has an expected lifespan of 40 years. So while it had been operational for some time when the short circuit took place that was still many years prior to the end of his expected operational life.

RSA has suggested adverse atmospheric conditions in the generator's location meant it would have deteriorated more quickly in that environment than would otherwise have been the case. However, that doesn't appear to be based on any expert opinion. And I can see the Chief Engineer of the specialist maintenance company responsible for the generator said "*the location and operating conditions are in no way extreme for installations of this type and the equipment has been operated in accordance with the manufacturer's instructions, with regular inspections and assessments of performance showing no sign of deterioration*". He went on to say "*indeed the equipment is certified to IP 23 meaning that it is even protected against spraying water*". And "*there is no reason to believe that [manufacturer's] stated 40 year design life does not apply*".

In relation to the gradual deterioration exclusion in the policy I'm mindful of the fact the actual damage was clearly caused by a sudden event which happened without warning (the short circuit). Given that, for RSA to fairly rely on the policy exclusion, I think it would need to show gradual deterioration as a result of corrosion was the proximate (the substantial and effective or dominant) cause of the damage. So it was because of the corrosion the short circuit took place – and that wouldn't have happened but for the corrosion. And as RSA are relying on a policy exclusion to turn down the claim the onus is on it to show, on balance, it applies. I've reviewed the evidence in relation to that.

The initial report from the generator specialist (who had disassembled the unit following the short circuit) said "*the main cause of generator fail is the interturn short out of the slot part*". And he identified visible surface corrosion (which is apparent in the photographs taken at the time). But he didn't draw a link between that corrosion and the failure of the generator.

That report and other evidence was then reviewed by a specialist forensic engineer appointed by RSA. In deciding what weight to attach to his report I'm mindful of the fact his opinion was based on a review of the photographic and other evidence and not an inspection of the generator itself. I also note he appeared to be unaware of key information about the circumstances of the claim such as the length of time the generator had been shut down for prior to the short circuit or its initial installation date. Nevertheless, I appreciate he did say "*I do not think that one can discount the lamination corrosion as not being the reason for the failure*". And he felt the generator was severely degraded by moisture "*as evidenced by the visible rusting*".

However, H then provided further information in support of its claim. That included a statement from the generator specialist which said "*the cause of generator failure was the interturn short in the stator winding end, out of the stator slots. Observed surface corrosion on some metal parts of the generator was not a cause of the failure*". Further comments from the generator maintenance company were also provided which included "*the windings that contained the failure are made of insulated copper, not in direct contact with the steel frame and stator metal sheets, and cannot corrode as is claimed*". I haven't been provided with any evidence from RSA's expert in response to those comments.

RSA does appear to have suggested the corrosion (and associated moisture ingress) was exacerbated during the period the generator was offline. And the report from its loss adjuster suggested in that period an anti-condensation heater on the generator hadn't been activated. I'm not clear if that's a position RSA is maintaining because in its final response to the complaint it said "*heaters may have been present during the two month period of inactivity*". In any event I can see H through its broker provided evidence which indicates during that period the generator had been maintained in accordance with the manufacturer's instructions. And I've not seen anything in response from RSA which suggests otherwise.

Nor has RSA provided any further evidence or comments in response to our investigator's view upholding the complaint. So the only information I have to take into account from it are those points contained in the response it provided to the inquiries we made. I've carefully considered that information but for the reasons I've explained in this decision I don't think on the basis of that information RSA has done enough to show (on balance) that the corrosion was the cause of the damage which H is claiming for. Or that the damage resulted from normal wear and tear.

Putting things right

I don't think RSA has fairly turned down this claim. So it will need to reconsider it against the remaining policy terms.

My final decision

I've decided to uphold this complaint. Royal & Sun Alliance Insurance Limited will need to put things right by doing what I've said in this decision.

Under the rules of the Financial Ombudsman Service, I'm required to ask H to accept or reject my decision before 31 July 2024.

James Park
Ombudsman